February 5, 2023

Re: Federal Reserve System, "Principles for Climate-Related Financial Risk Management for Large Financial Institutions"

To whom it may concern:

Thank you for the opportunity to comment on the draft principles intended to support large financial institutions in managing climate-related financial risks. This comment responds to questions #1 and 2, as listed in the Request for Comment, by pointing to ways that the draft principles could better address challenges raised by climate-related financial risks, and other aspects of climate-related financial risks that the Board should consider.

As a professor at the Nelson Institute for Environmental Studies at the University of Wisconsin-Madison, I am a social scientist whose research focuses on environmental governance, particularly of industrial expansion, including oil and gas pipelines. One of my recent publications shows that **private-sector financial institutions may not be able to self-regulate adequately** in order to avoid serious long-term financial risk. Moreover, beyond direct material impacts from climate change itself, which the draft principles discuss, climate change-related **risks also include stranded assets, and social activism** in response to fossil-fuel infrastructure.

While financial institutions understand the need for long-term financial planning, they are driven, largely through shareholder pressure, to generate profits in the short term. Their choices are governed by what is known as "herding" behavior, i.e. an aversion to behaving differently from their peers, due to concerns about lost opportunities for profit-making. Therefore, each institution, if operating in the absence of external regulations, will continue to invest in projects with long-term, climate-related risks as long as these can generate short-term profits, if their peers continue to do so.

Of course, institutions can collaborate in order to agree, jointly, on self-imposed guidelines for their investment decisions, and have done so. For instance, the Equator Principles are a framework created by and for financial institutions to identify and manage potential investments' environmental and social risks. However, for "Designated Countries" (defined by simultaneous membership of the Organization for Economic Co-operation and Development and inscription on the World Bank High Income Country list), including the United States, projects need only comply with "relevant

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host country laws, regulations and permits." Thus, the burden falls to government agencies, such as the Federal Reserve, to provide guidance as to a project's climate-related risks.

These risks themselves do not only include risks from the extreme weather events that will occur with increasing frequency and severity as climate change progresses. They also encompass the risk that assets such as oil and gas reserves will become "stranded" as international climate treaties and a transition away from carbon-intensive energy sources mean that those reserves cannot be exploited.

Also, and increasingly, grassroots resistance leads to delays, lawsuits, public relations disasters, and other serious costs for fossil-fuel projects, which decrease the projects' profitability. For instance, popular resistance to the Dakota Access Pipeline cost the company several billion dollars. The draft principles should identify and highlight such issues as serious financial risks.

Because of these additional risks, and financial institutions' inability to address them individually without government regulation, the Federal Reserve must:

1. Incorporate into the Principles for Climate-Related Financial Risk Management for Large Financial Institutions language addressing the need for financial institutions to **factor into their risk assessments**:
    a. the risk of fossil fuel reserves becoming **stranded assets**, and
    b. the risk of a decrease in profitability for fossil fuel-related projects due to **activism in resistance** to those projects.

2. Even more importantly, the Federal Reserve must **devise regulations** to prevent banks from investing in projects that are likely to face long-term risks from the above factors.

In summary, climate-related risks include risks additional to those currently noted in the draft principles, and the Federal Reserve must regulate financial institutions' investment choices, as they are not able to do so themselves.

Again, thank you for the opportunity to comment.

Sincerely,

Dr. Leah S. Horowitz

Work cited:
Horowitz, L.S. In press. The double movement and the triple-helix: Divestment, decommodification, and the Dakota Access Pipeline. *Environment and Planning A: Economy and Space*. https://doi.org/10.1177/0308518X221147299